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AGENDA ITEM 8b(1)

TO: MEMBERS OF THE INVESTMENT COMMITTEE

- I. SUBJECT:** Responsible Contractor Program Annual Report
(July 1, 2009 – June 30, 2010)
- II. PROGRAM:** Real Estate
- III. RECOMMENDATION:** Information Only
- IV. ANALYSIS:**

Summary

For the fiscal year 2009-2010, combined investment manager compliance and Housing Program voluntary compliance totaled 97.9%. Real Estate program managers paid in excess of \$877 million toward RCP contracts for the reporting period.

Background

The Responsible Contractor Program (RCP) Policy, adopted in August 2005, applies to all domestic real estate investment managers, single family real estate investments, joint ventures and partnerships where CalPERS has a greater than 50% ownership interest. The compliance information presented is limited to contracts of \$50,000 or greater. In accordance to the Policy, this agenda item reports program compliance for fiscal year 2009-2010. The following documents are attached:

- Attachment 1 - Investment Manager Combined Compliance Report: Core, Non-Core, and Housing
- Attachment 2 - Housing Program Voluntary Participation Report
- Attachment 3 - Since Inception Compliance
- Attachment 4 - Bidding Notification Method

In 2008, at the request of the Investment Committee, staff initiated a process to revise the RCP. The ensuing policy discussions identified manager and contractor neutrality as the threshold issue. Staff and legal counsel drafted an entirely new policy designed to gather experience and information on the impact, if any, of requiring neutrality in CalPERS Core Real Estate program.

In February 2010, the Investment Committee approved the Neutrality Trial Responsible Contractor Program (Neutrality Trial RCP) Policy and its corresponding Neutrality Trial Program (NTP). The Neutrality Trial RCP, effective April 1, 2010, applies to Core investment manager investments only, where CalPERS ownership interest is greater than 50%. Compliance information, beginning on the effective date, is limited to contracts \$100,000 or greater. Appendix 3 Section II.E. of the Policy states: "The Staff will report on NTP compliance and consequences in the RCP Policy Annual Report." In addition to Program compliance, this agenda item reports on activity under the NTP Policy for the periods ending June 30, 2010 and September 30, 2010.

All eight Core investment managers volunteered to participate in the NTP and as a result, the 2005 RCP Policy no longer applied to those managers. As of April 1, 2010, Core program investment managers will report under the Neutrality Trial RCP Policy. Please see Attachment 1 for Reporting Under the 2010 Neutrality Trial RCP Policy.

Contract and payment information provided herein is based on annual reports submitted by investment managers.

Findings

Real Estate Investment Managers Compliance

The domestic Core investment managers paid 99.9% of their total qualifying contracts to responsible contractors, while the domestic Non-Core investment managers paid 99.1% of their total qualifying contracts to responsible contractors. This represents a combined compliance of 99.4%.

The successful compliance rate is calculated using all qualified operating expenses and qualified tenant improvements and other capital expenditures. Please see Attachment 1 for partnership level reporting of compliance with the program.

Housing Program Investment Managers Voluntary Report

According to the current RCP Policy, the existing Housing Program managers are not required to comply with the Policy. However, voluntary compliance is strongly recommended. All of the Housing Program managers have voluntarily

submitted annual compliance reports. For the fiscal year 2009-2010, Housing Program investment managers awarded 95.4% of all qualified capital expenditure contract payments to responsible contractors. Please see Attachment 2 for Housing Program partnership level reporting.

Total Real Estate

For the fiscal year 2009-2010, combined investment manager compliance and Housing Program voluntary compliance totaled 97.9%. Real Estate program managers paid in excess of \$877 million toward RCP contracts for the reporting period.

Total contract payments and total RCP contract payments for the reporting year were down approximately 50% from the prior year. The dramatic reduction in contract activity is the result of reduced tenant improvement and capital expenditure contract payments for the reporting year. These contracts account for 93% of the total contract and RCP payments.

Staff remains dedicated to promoting continued compliance of the RCP. Please see Attachment 3 for since inception performance of the program.

Responsible Contractor Complaints

For the fiscal year 2009-2010, staff did not receive any RCP complaints.

Responsible Contractor Certifications

For the fiscal year 2009-2010, all real estate investment managers that are subject to the Policy have certified in writing that to the best of their knowledge, they have complied with the RCP and more specifically, with the roles and responsibilities stated within the RCP Policy.

Notification

The Real Estate Unit's investment managers and other stakeholders have been working together in the spirit of cooperation to promote consistency, and to improve the bidding opportunity notification process. Staff has encouraged the use of websites and e-mail communication as the preferred notification methods. Of the Real Estate Unit's 24 participating RCP investment managers, 17 have launched websites, and 7 have established e-mail notification processes. Real Estate staff recognizes the importance of timely notification to ensure the inclusion of responsible contractors in the bidding process. This year, staff has included the contact person and the contact's e-mail address for all investment managers using the e-mail bidding notification method. Please see Attachment 4 for investment managers' bidding notification methods.

Neutrality Trial Program

Quarterly Compliance Activity (April 1, 2010 - June 30, 2010)

As a means of understanding delegate and subdelegate participation, staff requested that investment managers provide a list of any delegates and subdelegates that have: 1) volunteered to be bound by the NTP; 2) did not volunteer to be bound by the NTP; and 3) any new contracts that were entered into during the period that are subject to the NTP. Additionally, staff requested that investment managers provide the relevant terms of those respective contracts (dollar amount, contract term, and brief scope of work). The results of the request are below:

- Fifty-three delegates and subdelegates volunteered to be bound by the NTP. Those contracts totaled approximately \$21.2 million.
- Seven delegates and subdelegates did not volunteer to be bound by the NTP. Those contracts totaled approximately \$2.5 million.
- Two new contracts, subject to the NTP, were signed. The contracts totaled approximately \$700,000.

There was no further activity to report for the period.

Quarterly Compliance Activity (July 1, 2010 - September 30, 2010)

At the time this report was finalized, staff had not yet received all NTP compliance reports from investment managers. There was, however, one neutrality exception to report in the quarter ending September 30, 2010.

The neutrality exception was regarding an asset at a secure airport site. The airport authority limited the number of companies approved to submit bids, due to security regulations, and neither of the two approved snow removal companies accepted the terms of the NTP. The exception was granted on August 27, 2010, at the Aero Syracuse property in the CalEast Global Logistics portfolio, managed by LaSalle Investment Management.

V. STRATEGIC PLAN

Goal IX to achieve long-term, sustainable, risk-adjusted returns by thinking creatively with respect to new investment opportunities and ensuring the sustainability of the portfolio returns.

VI. RESULTS/COSTS

There are no costs associated with this item.

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